

# ANALYSIS OF ORIGINAL BILL

## Franchise Tax Board

Author: Washington Analyst: Colin Stevens Bill Number: AB 203  
Related Bills: AB 741 (1997/98) Telephone: 845-3036 Introduced Date: 1/21/99  
Attorney: Doug Bramhall Sponsor: \_\_\_\_\_

**SUBJECT:** Employer Qualified At-Risk Youth Wages Credit

### SUMMARY

Under the Personal Income Tax Law (PITL) and the Bank and Corporation Tax Law (B&CTL), this bill would allow a credit equal to one-third of the wages paid or incurred by a qualified employer for the first year of employment of a qualified at-risk youth. The credit would be limited to \$5,000 per youth. Additionally, this bill would allow a credit equal to the amount paid or incurred by the employer for the services of a county probation or parole officer, not to exceed \$300 for each at-risk youth.

Under the Government Code, this bill would allow a county board of supervisors to impose a one-time fee upon a qualified employer of up to \$300 for the services of a probation officer in the supervision of a qualified at-risk youth.

Under the Penal Code, this bill also would require a probation officer to provide verification of an employee's status as a qualified at-risk youth.

This analysis will address the changes to the Government Code and the Penal Code only as they impact the Franchise Tax Board.

### EFFECTIVE DATE

This bill would specify that it would apply to taxable or income years beginning on or after January 1, 1999, and before January 1, 2004.

### SPECIFIC FINDINGS

**Federal law** provides special tax incentives designed to encourage employers to hire or train specified individuals, usually the unemployed or those in need of additional training. Federal programs include the federal Vocational Education Act of 1963, Job Training Partnership Act and the GAIN Program. California law makes reference to these federal programs in describing individuals qualified to participate in certain state programs and tax credits. In addition to these special tax incentives, existing state and federal laws allow a deduction for business expenses, including employee salaries.

**Existing state law** authorizes hiring tax credits, as well as other business tax incentives, which are intended to encourage business expansion and hiring in designated areas, including Enterprise Zones, Targeted Tax Areas, Manufacturing Enhancement Areas, and Local Agency Military Base Recovery Areas. In addition to these special tax incentives, existing state and federal laws allow a deduction for business expenses, including employee salaries.

### Board Position:

_____ S	_____ NA	_____ NP
_____ SA	_____ O	_____ NAR
_____ N	_____ OUA	_____ <u>X</u> PENDING

### Department Director

### Date

**Gerald Goldberg**

**3/10/1999**

Under the PITL and B&CTL, **this bill** would allow a credit equal to 33% of the amount paid or incurred as wages by a qualified employer to a qualified at-risk youth, not to exceed \$5,000 per qualified at-risk youth. The credit would be limited to the first year of employment of a qualified at-risk youth.

**This bill** also would allow a credit equal to the amount paid or incurred by the taxpayer for services of a county probation or parole officer for supervising each youth. This credit could not exceed \$300 per youth.

For purposes of **this bill**:

"Qualified at-risk youth" would mean an individual who:

- is 16 to 26 years old;
- has spent three or more consecutive months at a county juvenile home, ranch, camp, or forestry camp, or a detention facility of the Youth Authority in California within the three years immediately preceding employment with a qualified employer;
- is employed by the qualified employer for an average of at least 30 hours per week for a period of 12 months or more;
- is not related to the qualified employer.

An individual could be a qualified at-risk youth only once in a lifetime. An employer would not be able to claim a credit under this bill until the qualified at-risk youth has completed the time requirement specified above.

"Qualified employer" would mean a taxpayer who, with respect to the employment of the qualified at-risk youth, complies with all state and federal employer requirements and provides the youth with training in an employable skill or trade.

**This bill** would define "training in an employable skill or trade."

An employer who elects to claim a credit under this bill would not be eligible for any other credit with respect to wages paid to a qualified at-risk youth.

In the case where the credit allowed exceeds the amount of tax, the credit could be carried forward for eight years, or until exhausted.

Since **this bill** does not specify otherwise, the general rules in income tax law regarding the division of credits between taxpayers who share in the costs would apply. This credit would not reduce regular tax below tentative minimum tax for alternative minimum tax purposes.

**This bill** would require that the qualified employer enter into an agreement of confidentiality concerning verification of any time spent in a camp, ranch, etc. during the period the at-risk youth was under the age of 18. An exception would be made to allow an employer to provide information to the FTB to verify that an employee is an at-risk youth.

### Policy Considerations

The credit that would be allowed for services provided by a probation officer would equal 100% of identified costs, up to \$300. As a matter of tax policy, a credit for 100% of identified costs is unprecedented.

Conflicting tax policies come into play whenever a credit is provided for an expenditure for which preferential treatment is already allowed in the form of an expense deduction. This new credit would have the effect of providing a double benefit for the employer's wage expense. As the bill does not deny the current deduction for wages paid or incurred, the employer would otherwise continue to claim the deduction, as well as the credit set forth in this bill. On the other hand, disallowing otherwise allowable deductions to eliminate the double benefit creates a state and federal difference, which is contrary to the state's general conformity policy.

This bill would provide a tax credit for fees charged by parole or probation officers. However, this bill would not require that officers supervise youth in addition to their normal duties. If officers are not required to perform additional supervision of at-risk youths, the state would be indirectly subsidizing local governments for expenses local governments are currently required to perform.

### Implementation Considerations

Implementing this bill would not significantly impact the department's programs and operations.

### Technical Considerations

This bill would allow a credit for amounts paid or incurred during the first taxable or income year of employment of a qualified at-risk youth, but would require that a taxpayer claim the credit only after a qualified at-risk youth has satisfied the 12-month minimum service requirement. Amendments 1 and 3 would ensure that a taxpayer can claim prior year qualifying expenditures in the year in which the service requirement is satisfied.

The author's office has indicated that the carryover provision is intended to be limited to eight years. However, the bill's language could be read to provide an unlimited carryover. Amendments 2 and 4 would clarify the carryover limitation.

## FISCAL IMPACT

### Departmental Costs

This bill is not expected to significantly impact the department's costs.

### Tax Revenue Estimate

The bill is estimated to impact PIT and B&CT revenue as shown in the following table.

Fiscal Year Cash Flow Effective 1/1/99 Enactment Assumed After June 30, 1999 \$ Millions			
	1999-0	2000-01	2001-02
PIT Revenue	(minor)*	(\$1)	(\$3)
B&CT Revenue	(\$1)	(\$3)	(\$5)
Total	(\$1)	(\$4)	(\$8)

\* Loss less than \$500,000

This estimate does not account for any changes in employment, personal income, or gross state product that might result from this bill.

### Tax Revenue Discussion

The revenue impact of this bill would depend upon the number of employers who employ qualified individuals (at-risk youth), the average amount of qualifying expenses (wages and county probation costs) incurred for each qualifying employee, and average tax liabilities for credit purposes.

The estimated losses reflect applied credits in the respective years and were determined in several steps. First, the number of at-risk youth who would qualify an employer for the credit was based on information from the California Employment and Development Department (EDD). According to EDD an average of approximately 1,200 newly-hired individuals each month qualify private sector employers for the federal Work Opportunity Tax Credit (WOTC), which yields an estimate of approximately 15,000 individuals per year. For this estimate it was projected that approximately 18% of the individuals participating in the federal work opportunity program would be considered at-risk youth (between the ages of 18 and 24) and qualify private sector employers for the proposed credit. This was based on information from the County and City Data book for 1994 (a supplement of the U.S. Statistical Abstract) and yields a number of approximately 2,600 qualified at-risk youths. Based on the same source, this number was increased to include at-risk 16, 17, 25 and 26 year olds, yielding approximately 3,500 individuals annually who would enter the workforce and could qualify employers for the credit.

This number of at-risk youth entering the workforce annually was adjusted based on the following data and assumptions:

- One-half of the at-risk youths would be employed in enterprise zones and manufacturing enhancement zones.
- It was assumed that 65% of qualified employers located within these zones would instead elect to claim the credit allowed by this bill instead of those allowed zone businesses because of existing income and tax allocation requirements for determining "zone" income and tax liabilities for applying zone tax credits.

These limitations would not apply under this bill's credit proposal. This conclusion was based on a sample of approximately 50 corporate taxpayers who claimed approximately 85% of all hiring and sales credits attributable to enterprise zones and program areas for the 1993 taxable year.

The next step was to determine the average credit per employee. For this estimate assumptions were made that the average wage credit per employee would be approximately \$2,987 ( $\$5.75/\text{hour} \times 30 \text{ hours/week} \times 52 \text{ weeks} = \$8,970/\text{year} \times .333 = \$2,987$  average credit), and that the average county charges per employee would be \$250 for a total credit of \$3,250 per employee.

BOARD POSITION

Pending.

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FRANCHISE TAX BOARD'S  
PROPOSED AMENDMENTS TO AB 203  
As Introduced January 21, 1999

AMENDMENT 1

On page 5, between lines 31 and 32, insert:

(4) Any amounts paid or incurred by a qualified employer to a qualified at-risk youth in any taxable year prior to the completion of the 12-month service requirement specified in subparagraph (C) of paragraph (1) of subdivision (b), shall, for purposes of this section only, be treated as having been paid or incurred in the taxable year in which the 12-month minimum service requirement is completed.

AMENDMENT 2

On page 5, amend lines 35-36 as follows:

succeeding seven years if necessary, or until the credit is exhausted, whichever occurs first.

AMENDMENT 3

On page 7, between lines 31 and 32, insert:

(4) Any amounts paid or incurred by a qualified employer to a qualified at-risk youth in any income year prior to the completion of the 12-month service requirement specified in subparagraph (C) of paragraph (1) of subdivision (b), shall, for purposes of this section only, be treated as having been paid or incurred in the income year in which the 12-month minimum service requirement is completed.

AMENDMENT 4

On page 7, amend lines 35-36 as follows:

succeeding seven years if necessary, or until the credit is exhausted, whichever occurs first.